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SUBJECT: GOM Touts "Record" Manufacturing Investment Approvals for 2006; Rampant "Ali Baba" Abuses in GOM's Affirmative Action Program Draw PM

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¶1. (U) Summary: The GOM trumpeted figures showing total manufacturing investment approvals in Malaysia rose 48.1% in 2006 to a record RM 46 billion (USD 13.1 billion), and used this as proof the country remained internationally competitive. However, a closer look at the numbers reveals the investment trend in Malaysia is a lot less rosy. Meanwhile, Prime Minister Abdullah publicly vented his frustration over a recent study showing 85% of government construction tenders awarded to ethnic Malays under the GOM's affirmative action program are being sold to non-Malays, defeating the purpose of the policy. In response, the GOM has vowed to get tough on violators. End summary.

We're In the Money!

¶2. (U) Minister of International Trade and Industry Rafidah Aziz announced February 13 that Malaysia's total manufacturing investments approvals rose 48.1% in 2006 to an unprecedented high of RM 46 billion (USD 13.1 billion), from RM 31 billion projects approved in 2005. Of this amount, foreign manufacturing investment approvals accounted for RM 20.2 billion (USD 5.77 billion), an increase of 13.1% from the RM 17.9 billion (USD 5.11 billion) approved in 2005, while domestic investment approvals accounted for RM 25.8 billion (USD 7.37 billion), almost double the RM 13.2 billion (USD 3.77 billion) approved in 2005, primarily due to fourth quarter approvals for three large petroleum and petrochemical projects (see paragraph 5).

¶3. (U) The largest share of foreign direct investment approvals continued to be in the electronic and electrical sector, accounting for RM 8.6 billion (USD 2.5 billion) or 42.6% of the total. Japan emerged as the top investor for 2006 with RM 4.4 billion (USD 1.25 billion) in investment approvals, of which RM 1.5 billion (USD 430 million) will be in greenfield industries. [Comment: Japanese embassy economic counselor Takuya Sasayama told the press that the spike in Japanese FDI during the second half of 2006 may be the result of the Japanese-Malaysia Economic Partnership Agreement, which became effective last July. End comment]. The Netherlands came in second place with RM 3.3 billion (USD 943 million) in investment approvals, followed by Australia with RM 2.6 billion (USD 743 million). The U.S. slipped to fourth place with RM 2.5 billion (USD 714 million) in investment approvals, down from its number one position in 2005. About 60% of the U.S. company investment approvals will be re-investments by existing companies for expansion or diversification in the electronic and electrical sector.

FTA "Just a Bonus"

¶4. (U) The surge in investment approvals exceeded the GOM's targeted average investment approvals of RM 27.5 billion (USD 7.8 billion) per year under the 15-year Third Industrial Masterplan. In press reports, Rafidah said "[d]espite the increasing global competition, Malaysia continues to attract global foreign investment outflows, reflecting the country's cost-competitiveness as a manufacturing and export base." She added the figures demonstrated that a failure to reach a free trade agreement (FTA) with the U.S. would not have an adverse impact on foreign direct investment (FDI) into Malaysia. "The FTA is just another bonus", she said.

Hey, wait a minute...

¶5. (U) A closer look at the numbers reveals the sharp rise in Malaysia's investment approvals last year may not be sustainable. Three major dc

¶6. (U) Another dark cloud for Malaysia in last year's numbers is that fact that total investment approvals in the high value-added electrical

Now Show Me the Money

¶7. (U) The RM 46 billion in investment approvals does not refer to actual investments in Malaysia but rather projects that have been given the

"Ali Baba" and the Bumi Thieves

¶8. (U) Meanwhile, Prime Minister Abdullah Badawi expressed frustration and disappointment over findings from a recently released Ministry of Works report showing 85 percent of government contracts awarded to "Bumiputra" (ethnic Malays and indigenous Malaysian groups) contractors under Malaysia's affirmative action program end up being subcontracted to non-Bumiputra firms, a practice commonly referred to here as "Ali Baba". "They (Bumiputra) do not want to work, do not want to learn, and give little importance to the opportunities provided by the government...This approach will only make us hope and wait for aid and subsidies. Such a mentality thrives among the people, including Bumiputra petty traders and contractors," he said. Abdullah made the comments during a dinner speech on February 13th.

¶9. (U) In Malaysia, many government construction contracts are open only to Bumiputra owned businesses. Although the rationale for the policy

You Can't Trust Anyone Anymore

110. (SBU) A source from the Ministry of Works told EconFSN that their report, entitled "Study on Bumiputra Contractor Leakage", was the result

Blacklist the Really Bad Bumis

111. (SBU) Separately, executive chairman Moehamad Izat Emir of the Malay Entrepreneurs and Merchants Association said payment is the main issue facing the contractors. He said that while Abdullah had directed the disbursing agency to pay the contractors within two weeks after completing the work, this often does not happen. He proposed that Bumiputra contractors be trained to upgrade their skills and suggested government-linked companies (GLCs) be required to support these contractors. Roslan Awang Chik of the Malay Contractors Association shared his view that "competency comes from exposure". He is puzzled why many well-known and qualified Bumiputra contractors were not being awarded government contracts while several unknown ones were. He suggested the government blacklist any contractors found to be selling their tenders. "They can be considered traitors", he said.

Now Promise to be Good...

112. (U) In response to the controversy over the study, Ministry of Finance Secretary General Izzudin Dali announced on February 16 that under new regulations Bumiputra contractors seeking government tenders will soon be required to sign an official declaration promising not to sell or subcontract their tender to other races. Violators will have their contracts and registrations terminated. Izzudin added that under the new rules contractors undertaking public infrastructure contracts will now be awarded only one project at a time and that projects will be distributed evenly among contractors in the same area or district.

113. The GOM's practice of giving preferential treatment to Bumiputra contractors began as part of its New Economic Policy, an ambitious and controversial affirmative action program launched in 1971 following the race riots of the late 1960s. Although aimed at reducing the socioeconomic disparity between Malaysia's Chinese minority and its Malay majority, these policies have been only partially effective while often stirring resentment on the part of non-Bumiputra ethnic groups. According to the GOM's last census in 2000, Malaysia ethnic composition is 65.1% Bumiputra, 26.0% Chinese and 7.7% Indian.

114. (SBU) Comment. The current system of awarding lucrative government contracts to bumis provides them with a strong economic incentive to simply act as agents, turning over as many projects as possible and taking a cut before handing each one off to a competent non-bumi implementer. This "bumi agent" system is firmly entrenched in Malaysia. Any effort to make reforms is likely to be resisted not only by well-established bumis, but also by the non-bumi implementers who have built up a network of well-oiled agent partnerships. End comment.

SHEAR